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Weekly Review

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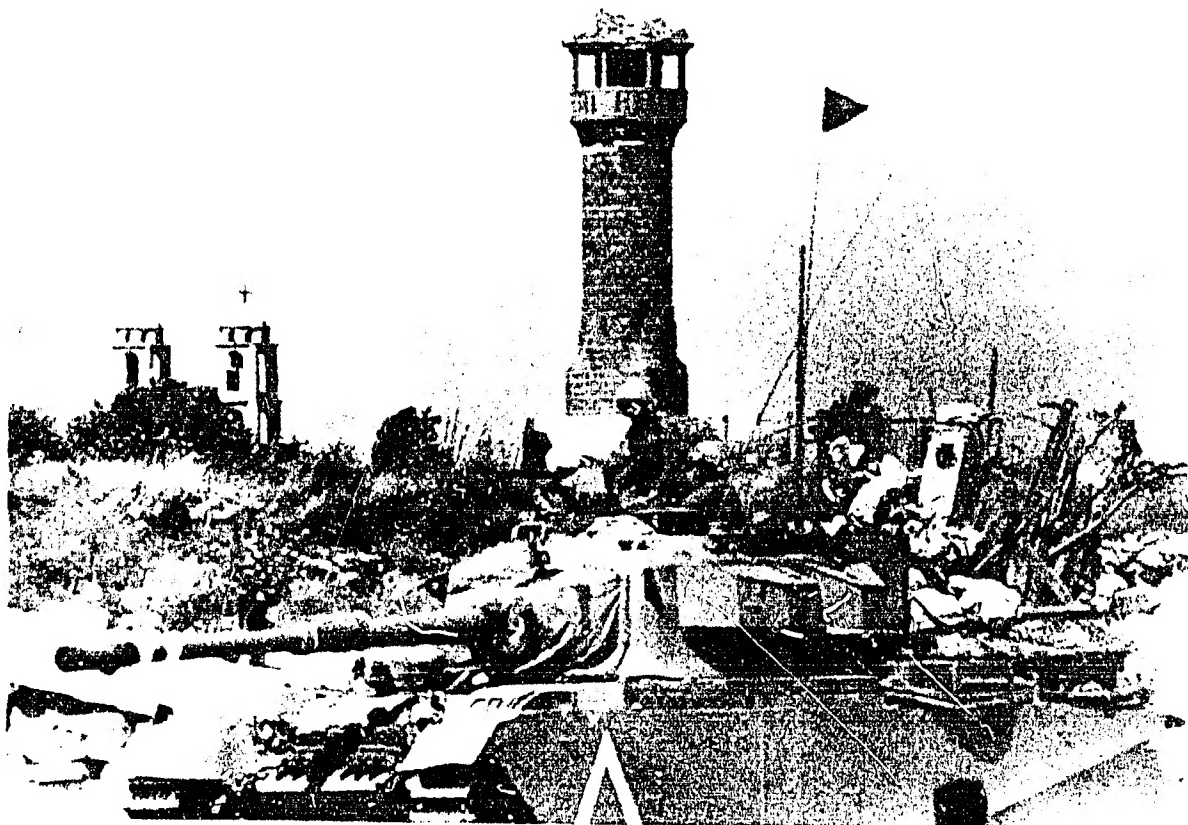
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28 June 1974

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Israelis withdraw from al-Qunaytirah

THE MIDDLE EAST

DISENGAGEMENT COMPLETED

Disengagement of Syrian and Israeli forces on the Golan Heights was completed without significant problems by June 26, the date specified in the agreements signed early this month. In the last stage, Israeli troops turned over to UN forces the former Syrian administrative capital of al-Qunaytirah, Rafid village to the south, and positions on the peak of Mount Hermon to the north. In accordance with provisions of the disengagement agreement, the UN then returned the two towns to Syrian civil control, although both will remain in the UN-patrolled neutral zone. The

Mount Hermon positions will continue under full UN control.

JORDAN REACTS

In an effort to put pressure on the negotiating parties before the next round of peace talks, Jordan's King Husayn has publicly threatened not to participate at Geneva unless a Jordan-Israel disengagement accord is first worked out. The King told a press interviewer on June 23 that Israel would have to pull back a "reasonable depth" from the Jordan River as a prerequisite for Jordanian participation at Geneva. Husayn

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Israeli soldiers reinforcing border with Lebanon

indicated that Egypt and Syria would also have to work out a common strategy with him before the Geneva conference reconvenes. Husayn clearly hopes to force Cairo and Damascus to support his efforts to get the disengagement negotiations with Israel rolling.

Although Israel is apparently still undecided on how to proceed with Amman, it is unlikely to agree to a withdrawal from the Jordan River as quickly as Husayn would like. The government has already committed itself to call national elections to ratify such a step, and Prime Minister Rabin's Labor Alignment, fearing electoral setbacks, does not want to face the voters for a while. Rabin also prefers to conclude an additional agreement with Egypt before talking with Amman, although he may agree to start negotiations with Jordan before an accord with Cairo is actually signed.

In the interview, Husayn reiterated that he had no objections to the Palestine Liberation Organization attending the Geneva talks. Husayn offered, as he has previously, to step aside in favor of the fedayeen-controlled organization if

that was the wish of the other Arab states. Otherwise, he said, the Palestinian group's mandate should be limited to handling the still vaguely defined question of "Palestinian rights," while Jordan negotiated the return of the West Bank and East Jerusalem to Arab hands.

FEDAYEEN TERRORISM...

For their part, the fedayeen kept up their campaign of terrorist raids on Israeli population centers. On June 25, three commandos raided an apartment building in Nahariya, a seacoast resort near the Lebanese border, killing four Israelis before they themselves died. Fatah, the largest and most influential of the Palestinian groups, claimed responsibility for the attack, which the Israelis say was launched by sea from Lebanon. This was the fourth attack by fedayeen terrorists since mid-April. Altogether they claimed the lives of 53 Israelis.

Fatah has not been involved in such an attack for some time, but has always approved the principle of direct strikes at Israel. The group almost certainly acted at this time both to counter fedayeen radicals who are criticizing Arafat for his pro-negotiation policies and to remind those already involved in direct negotiations that even the relatively moderate fedayeen groups will resort to terrorist tactics if the Palestinians are not invited to participate in the peace talks on acceptable terms.

...AND ISRAELI REPRISAL

Prime Minister Rabin told the Knesset shortly after the Nahariya incident that Lebanon bears full responsibility for terrorist operations planned on or launched from its territory. In an apparent initial reprisal, Israeli artillery shelled several towns in southern Lebanon on June 25 and 27. The Israelis, who last week carried out heavy air strikes on fedayeen bases in and around refugee camps in Lebanon, are likely to continue reprisals even though they seem to make the fedayeen more determined to carry on their terrorism.

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SUDAN: TERRORISTS RELEASED

President Numayri on June 24 commuted life sentences imposed that day on the eight Palestinian terrorists who murdered two US diplomats and a Belgian in the Saudi embassy in Khartoum in March 1973. The Palestinians were immediately flown out of the country and transferred to the "custody" of the Palestine Liberation Organization, a move that virtually frees them.

The speed with which the case was suddenly wrapped up and with which the terrorists were dispatched from Sudanese jurisdiction suggests the execution of a scenario planned well in advance. Numayri was careful not to tip his hand. Despite the political sensitivity of the case, he had insisted on strict observance of the judicial process and had left the impression with US officials and foreign newsmen that he favored holding the terrorists to account. Cabinet ministers had indi-

cated, however, that the Sudanese found it difficult to be the only Arab country ever to have brought Palestinian terrorists to trial. They implied, in effect, that the terrorists would be given executive clemency.

Minister of State for Foreign Affairs Ahmad—Foreign Minister Khalid initially made himself unavailable—told the US ambassador that Sudan did not want to take an action that might increase tension and "set back" progress in resolving the Arab-Israeli conflict achieved by recent US diplomatic efforts. Numayri, in weighing the risks involved, apparently preferred to incur the displeasure of the US than to face a political backlash from the other Arabs and the threat from the fedayeen to his own security and that of Sudanese aircraft and diplomatic missions.

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EGYPT-USSR: REVIEWING TIES

Egyptian Foreign Minister Fahmi will go to Moscow in mid-July for a fundamental review of Egyptian-Soviet relations. Although the visit comes in a period of renewed surface friendliness, strains are likely to re-emerge over such questions as arms deliveries, a summit that Fahmi will attempt to arrange, and the strategy and timing of Arab-Israeli peace talks.

Uppermost in Fahmi's mind will be the arms shipments that Moscow suspended in April. He will reportedly insist that President Sadat must know whether to count on a resumption of military aid or to assume that he can expect none. Fahmi will emphasize, as he and Sadat have done in public, that Egypt is not seeking better relations with the US at Soviet expense.

Cairo's particular concern for the future of the Egyptian-Soviet military relationship has both a political and a practical motivation. Military aid is the most tangible and only virtually irreplaceable benefit that Egypt feels it derives from its ties with the Soviets. In the Egyptian view, the

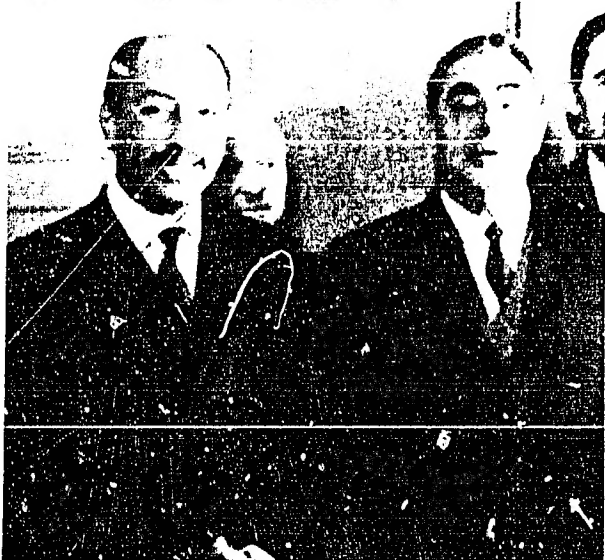
resumption of amicable relations will largely depend on a resumption of arms shipments. More than this, there is undoubtedly pressure from the military in Egypt for some relief from a situation that has left Cairo without a flow of spare parts for over two months.

The Soviets, for their part, may be amenable to requests for a restoration of the arms flow. At this point in the peace negotiations and in the US-Egyptian relationship they may see arms as the only means of guaranteeing some continued influence in Egypt.

A favorable Soviet response on the arms question is probably an Egyptian requirement for proceeding with arrangements for a summit between Sadat and the Soviet leadership, which Fahmi has announced as the purpose of his visit. The arrangements for such a meeting could in themselves cause renewed wrangling. Each side will press for its own capital as the venue, with the Egyptians arguing that, in view of Sadat's four trips to the USSR, it is the Soviets' turn to do the visiting.

Although Moscow may accede on this question as well, the Egyptians may be disappointed in their expectation that Brezhnev would make the call. Brezhnev, who has not been in the Middle East since becoming party chief, would find it politically difficult to visit Cairo so closely on the heels of President Nixon's successful visit. The more likely candidate for the trip would be either Kosygin or Podgorny.

Fahmi's Soviet hosts will undoubtedly also raise the subject of the Geneva conference during his visit, urging its quick reopening in order to reinsert themselves as active participants in the negotiations. Sadat, on the other hand, is proceeding more slowly. He wants to coordinate divergent Arab positions before moving on to the next stage and does not anticipate returning to Geneva before September.



Sadat and Brezhnev in 1972

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RHODESIA: ELECTION SCHEDULED

Prime Minister Ian Smith dissolved Parliament last week and announced that a general election will be held on July 30. Smith apparently hopes that a fresh mandate from the predominantly white electorate will strengthen his hand for a new attempt to reach a constitutional agreement with the leaders of Rhodesia's black majority—a prerequisite for British recognition of Smith's government and termination of international economic sanctions. Prospects for an early agreement have dimmed, however, as a result of the sudden arrest of a prominent spokesman for the African National Council, the largest black group in Rhodesia.

Smith's Rhodesian Front Party now holds 49 of the 50 white seats in the House of Assembly. Africans hold 16 seats under a restricted franchise. A general election is not legally required until April 1975, but Smith told Parliament he wants to dispel "the present state of uncertainty" among white Rhodesians, which he related to the African National Council's rejection in early June of his latest constitutional proposal. Smith had offered to increase the black seats to 22, but his formula for gradually broadening the franchise would prevent Rhodesian blacks, who outnumber whites 20 to 1, from gaining a majority in the assembly for at least 40 years. In announcing the election, Smith said he will make a new attempt to resolve the constitutional impasse by convening a "truly representative round-table conference" after the election.

Smith probably sees an election campaign, in part, as an opportunity to allay qualms among Rhodesian whites concerning the coup in Lisbon and its implications for southern Africa. A black government in neighboring Mozambique is anticipated, and it is widely assumed that such a government will favor the Rhodesian guerrillas who have been infiltrating through northwestern Mozambique from bases in Zambia and Tanzania. Although Smith now ridicules such fears, he no doubt foresees that a new regime in Mozambique may at least restrict Rhodesian trade outlets through Mozambican seaports, unless international sanctions are terminated.

Shortly after calling the election, Smith announced that Dr. Sithole, publicity chairman for



the African National Council, was being detained without trial—the government's standard procedure for dealing with individuals suspected of subversion. No reason was given for the action. Smith has claimed, however, that some members of the council are linked with the guerrillas who have been active in the northeast sector of the country since late 1972.

Smith may hope that the detention of Sithole, whom he apparently regards as a key opponent of the proposed constitutional settlement, will bring other council leaders around to accepting the terms. Smith claims that Bishop Muzorewa, the president of the council, had approved the proposal but was overruled by a militant faction in the leadership group. Muzorewa has declared, however, that he will not resume negotiations with Smith unless Sithole is released.

Rhodesian whites probably realize that the impasse between Smith and the African National Council precludes an early settlement with Britain and relief from economic sanctions. Most whites, however, will probably vote for Smith's party next month because they see no acceptable alternative. The moderate Rhodesian Party has failed to counteract Smith's claims that it encourages black militants. The detention of Sithole may serve to undercut the right-wing Rhodesian National Party as well as extremists in Smith's own party.

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NATO: AFTER THE MINISTERIALS

A rare degree of harmony prevailed during the NATO ministerial meetings earlier this month. The European members of the Alliance had many of their fears assuaged, and all of the allies seem inclined to avoid airing their differences.

The eight defense ministers who compose the Nuclear Planning Group reacted favorably to Secretary Schlesinger's briefing on US plans for strategic retargeting, many of them commenting that the Alliance's deterrent capability had actually been enhanced. The result was a further softening of the lingering West European concern that the US-Soviet agreement on the prevention of nuclear war places limits on what the US would do to defend Europe.

The new declaration of Atlantic principles, the major accomplishment of the foreign ministers' session in Ottawa, was something of an anticlimax after months of effort. In proclaiming that the Alliance is the "indispensable basis" of its members' security and that an attack on one will be considered an attack on all, the declaration merely reaffirms the principles on which NATO has been based from the very beginning.

There are important new elements as well. One of these is a pledge by the US to maintain its European forces at a level sufficient to carry out the strategy of deterrence and to defend the North Atlantic area if deterrence should fail. This pledge is designed to reassure the Europeans who fear that the US will eventually make substantial unilateral withdrawals, even while negotiations for mutual troop reductions are continuing with the East.

The declaration also smooths European feathers by highlighting the security and political importance of the European Community to an extent unprecedented in such documents. Progress toward unity of the EC states, the declaration says, will eventually have a beneficial effect on the common defense of the Alliance. The declaration might have gone further on this point had it not been for the British, who resisted any outright reference to "European union." Foreign

Secretary Callaghan has made the point repeatedly that he cannot endorse "European union" until someone can explain to him what it means.

The declaration explicitly mentions British and French nuclear forces as capable of contributing to the deterrence strategy of the Alliance as a whole. While the mention of French nuclear forces in the declaration is clearly made in the Atlantic context, there have been some signs that the Giscard government may be rethinking the ways in which France cooperates with the other West Europeans in the defense area. Both French Gaullists and the left have denounced this and other provisions of the declaration as excessively "Atlanticist."

The most troublesome paragraph in the declaration to agree upon--and as a result one of the weakest--deals with US - West European consultations. US irritation with EC positions, which are nearly immutable because they already represent compromises among the Nine, has been matched by the feeling of the EC that its interests are often ignored by the US. Despite these serious concerns on both sides, the declaration merely contains language which notes that the common aims of the Alliance can only be achieved through close consultation. The French objected to any wording that implied a legal obligation on the part of either the US or the Europeans to consult, especially on their overall economic and political relations and events outside the NATO context.

Several of the participants in the Ottawa meeting stressed that the recommendation for more consultations will have meaning only if the countries involved wish it. The West Europeans consider the Nixon-Brezhnev summit a test. They are concerned that concessions might be made on the European security conference and the force reduction talks. European interests are deeply involved in both. As one observer put it, they will be looking for the US to show that the logic of the Western Alliance is at least as valid as the special relationship between super powers.

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[REDACTED]

In agreeing upon the new declaration of principles, the West Europeans have been reminded that there is no present defense alternative to an alliance with the US, and that it is behind the shield of NATO that Europe can most safely debate plans for defending itself in the future. The basic problems between the US and the West Europeans have not gone away, but the change in the weather represented by the ministerials—if it lasts—may make some of them easier to tackle. [REDACTED]

ICELAND: VOTING ON KEFLAVIK

Iceland's major political parties have made the future of the Keflavik base the number one campaign issue in the election this Sunday. There has been little mention in the campaign of the economic crisis that brought down the center-left government of Prime Minister Johannesson in May. The outcome of the election, therefore, will be interpreted as a referendum on the question of whether to retain the base in the defense agreement to be renegotiated later this year between the US and Iceland.



Although all of the parties have called for a review of the defense agreement, the opposition conservative Independence Party has been the most flexible. Party leaders issued a statement on June 23 strongly endorsing retention of the base.

Voter discontent with the outgoing coalition's handling of the base negotiations and the defense issue generally has been a major factor in the bright electoral prospects of the Independence Party. Leaders of the party were active in promoting the successful pro-base signature campaign last February. In addition, the party claims that it alone has a consistent policy for the defense of Iceland.

As members of the outgoing coalition, the Progressives, the Liberal Left Organization, and the Communists will have a more difficult time convincing voters that their policy toward the base should be continued. In March, the government tabled proposals for the withdrawal of all forces from Keflavik by 1976. Negotiations began shortly thereafter but were suspended when the government fell in May.

Throughout the electoral campaign the three parties have taken differing positions on the base—the Communists, of course, vigorously opposing its continuation. The Progressives, who claim that only they have taken a balanced position between left and right extremes, have called for continued membership in NATO but with the proviso that no foreign troops be stationed in Iceland during peacetime. The remaining coalition partner, the Liberal Left Organization, has been appealing to non-Communists among anti-base elements. The Social Democrats, who together with the Independence Party comprise the opposition, support retention of the base.

The municipal and local elections on May 26 were billed as a preview of the national contest, but the outcome was inconclusive. The Independence Party captured more than 50 percent of the votes, but the Communists also picked up strong support. Parties of the center suffered significant losses. [REDACTED]

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UK: WILSON ON THE DEFENSIVE

Britain faces the likelihood of elections this fall as a result of the sudden flare-up of parliamentary warfare last week that clearly revealed the shaky position of the minority Labor government.

Two significant parliamentary defeats ranked Prime Minister Wilson, but they do not pose an immediate threat to his government nor are they likely to lead to elections in July or August—traditional summer holiday months for Britons. Parliament rejected a Labor attempt to allow the unions to reclaim the more than \$20 million they forfeited for failing to register under the Industrial Relations Act. The opposition also passed a motion deploring Labor's plans to extend nationalization of British industry.



Despite persistent speculation that Wilson might call a snap election, all parties appear to prefer more time to prepare. Labor is running ahead in opinion polls, but the Tories have narrowed the gap recently.

From Labor's point of view, the best time for an election would appear to be September or October. The party presumably would postpone its annual conference, usually held in October, until after the election. In the past, the conference has only served to publicize the deep divisions within the party. For this reason, Wilson would prefer to hold the election before the party conference.

Wage controls are scheduled to end in early November, and worker unrest and strikes are likely to increase toward the end of the year. An election in the fall would still enable Labor to seek a new mandate while blaming the country's continuing economic and other problems on the previous Conservative government.

The Conservatives are gearing up for fall elections, and party leader Edward Heath has announced that he intends to increase the effectiveness of the Tories as an opposition party. As a first step, Heath reshuffled the shadow cabinet last week and served public notice that the Tories intend to continue their aggressive attacks on the Labor government's policies in the weeks remaining before Parliament's summer recess.

In reshuffling the shadow cabinet, Heath promoted William Whitelaw to the Tories' number two slot. Whitelaw attained wide recognition for his handling of the Ulster problem and is one of the Conservatives' most popular figures.

The Liberals, too, are reworking their strategy for the elections. In an about-face, the party's parliamentary delegation declared that it is prepared to join a coalition government after elections are held. The shift comes barely four months after the last general election, at which time the party flatly rejected a coalition with the Conservatives.

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The Liberal platform is broad enough to allow an alliance with either the Tories or Labor, but Prime Minister Wilson has emphatically ruled out the possibility of a coalition. The Liberal move, therefore, will be read by many as a deliberate attempt to form an alliance with the Tories. Before a coalition is possible, however, the Liberal members of parliament will have their hands full convincing the party rank and file of the advantages of cooperating with the Tories.

The Liberals proved in the February elections that they have considerable appeal by attracting many voters dissatisfied with the two major parties. Liberal leaders apparently have concluded that the only way they can influence national policy is by directly participating in the government

ders of the recently formed centrist Popular Democratic Party. The commission has accused him of misusing his authority for the benefit of his party and has demanded his resignation.

The government has also moved to clamp down on leftists who have gone too far in taking advantage of the new civil liberties in Portugal. The open sympathy of the mass media toward the left prompted the government, on June 14, to take over the management of a Lisbon television station, and last week the key administrative positions in the radio network were assumed by military officers. In addition, militant leftists have been arrested for a wide range of offenses, ranging from trying to persuade soldiers to desert to inciting labor unrest.

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PORTUGAL: SPINOLA TIGHTENS CONTROL

President Spinola and the provisional government are stiffening their resistance to the takeover of local government bodies by the Communists and are moving to halt abuses of civil liberties by extreme left-wing organizations. The Portuguese Communist Party is anxious to maintain its image of respectability while mobilizing support for elections next year.

The control of local governments is crucial in the present struggle for political power. The US embassy in Lisbon estimates that the Communist-dominated Democratic Electoral Commission has gained control of a third of Portugal's 304 town councils since the coup last April. The commission took over the councils by organizing "public discussions" to nominate slates of commission candidates, which were then selected in similarly orchestrated "elections."

The minister of internal administration, Joaquim Magalhães Mota, is now refusing to verify the credentials of some of the officials selected by this process. Mota is one of the foun-

The Communist Party has avoided direct criticism because of its desire to dissociate itself from the actions of militant leftists and to project the image of a responsible member of the provisional government. Although Communist influence in the government is heavily outweighed by center and right-wing elements, the party is content to consolidate its influence in key sectors of Portuguese society in preparation for elections next year. The party is, in fact, genuinely concerned that irresponsible behavior by the extreme left will provide the rightists and centrists in the Portuguese power apparatus with a pretext for placing repressive controls on election campaign procedures.

There appears to be no significant challenge to the supremacy of President Spinola and the junta in the Portuguese power structure at this time. The military leaders have shown that they have the power to control the left and are prepared to use it. As long as the Communist Party stands to gain popular support from its association with the provisional government, it will continue to cooperate. A confrontation between the party and the government remains a possibility, however, particularly if Spinola and his colleagues take a tougher stance in their efforts to prevent the Communists from extending their influence.

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Arias

SPAIN: MARKING TIME

Spanish authorities appear to be anxious to limit the effects of the fall of Salazarism in Portugal on the Spanish political scene. The slow pace of social and political change promised by Prime Minister Arias, and the sudden dismissal of General Diez-Alegria are reflections of this caution.

After maintaining a low profile for some weeks, Prime Minister Arias moved to center stage this month with a five-day visit to Catalonia, a principal area of regional discontent. Accompanied by seven of his ministers—each of whom also talked to leaders in their respective fields—Arias left the impression that his government would continue toward its declared aim of increasing participation of citizens in public life, improving conditions in the universities, maintaining liberalization in the press, increasing its involvement in social and labor matters, and improving church-state relations.

In a nationally broadcast speech, Arias reiterated his intention to establish political associations in order to increase participation in political life, a key element of his government's program.

He weakened the proposal, however, by stressing that the associations must function within the framework of the National Movement, established by Franco as Spain's sole political organization. Arias stated that there is room for diversity of opinion within the Movement, but he did not, as some had hoped, set a timetable for establishing associations.

The Prime Minister's performance thus far suggests that political reforms will come slowly. Of the several liberalizing measures he announced last February, only the bill providing for the direct election of mayors has been sent to the parliament for action.

The hopes of Spanish liberals were also set back this month when the relatively liberal chief of the military staff, General Manuel Diez-Alegria, was replaced by a conservative general. Some Spanish officials have tried to portray the ouster as a normal rotation, but it seems more likely that he was removed because of his identification with civilian elements who favor reform of the Spanish political system. Diez-Alegria's public statements have indicated that he was surprised by his dismissal.

Diez-Alegria has made it clear in private conversations that he is outraged by allegations circulating in Madrid that he was fired because he had established unauthorized contact with the exiled secretary general of the Spanish Communist Party. He is also upset because he was not accorded customary honors and decorations that usually accompany the departure of a military figure of his stature.

Although Diez-Alegria has lost his place in the military hierarchy, he could still play an important political role. He is considered by some Spaniards as a potential leader who would take Spain along the same path followed by General Spínola in Portugal. These disgruntled Spaniards may be encouraged by the fact that after General Spínola was fired, he returned to head a liberal regime.

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FRENCH COMMUNISTS AND MOSCOW

The French Communist Party's attempt to broaden its base, to put more distance between itself and Moscow, and to become "a party like all the others" may be creating significant strains in its relationship with the Soviet Communist Party. These strains appear to have prompted the visit to Paris on June 19-24 of a Soviet delegation led by Boris Ponomarev—the Central Committee's chief of relations with free world communist parties.

Ponomarev found the French party less malleable than in the past. The communique issued after the visit made it clear that there was little meeting of minds on key issues, in particular, on reconciling the French party's views of its interests with Soviet foreign policy.

French Communist leaders have become increasingly committed to participation in a "common program for governing" with the Socialists and other left-wing parties that could eventually lead to a common front government. During the recent campaign, the Soviet Union sent Ambassador Chervonenko to call on Giscard, thus under-

lining its displeasure with the Communists' alliance with Francois Mitterrand's Socialists.

French party leaders were furious over the Soviet intervention in the campaign. This affront resulted in the first direct public criticism of the USSR by the French Communist Party since the invasion of Czechoslovakia six years ago.

As the campaign went on, Georges Marchais, general secretary of the French party, diverged significantly from the Soviet line in an attempt to appeal to a wider spectrum of leftist support. Since then, according to a senior French journalist, the Communists have no longer endorsed Moscow's opposition to the French nuclear force. The Communists are now arguing that, although land-based missiles should be eliminated—since they could only be targeted against the Soviet Union—the nuclear submarine force should be retained.

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Marchais has been sharply and openly critical of the lack of Soviet support for the left's election campaign against Giscard. The Communist newspaper, *L'Humanite*, has also begun to temper its unconditional support for Soviet policies.

Marchais is trying to overcome the fact that the appeal of the Communist Party in France, especially among the young, is limited by its past subservience to Moscow. Immensely buoyed by the closeness of the election results, the French Communists are anxious to create an appearance of independence from the Soviets.

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Georges Marchais

ITALY'S AUSTERITY PROGRAM

The austerity program devised by the Rumor government last week should improve Italy's credit standing and trim at least \$1 billion from the 1974 import bill.

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The proposed fiscal and monetary measures represent a compromise between the Christian Democrats, who favored draconian measures to curb imports and inflation, and the Socialists, who wished to maintain employment and increase welfare spending. The patchwork program aims to boost tax revenues by \$4.7 billion annually, while reducing the income tax bite on low-income groups. As a concession to the Socialists, the Christian Democrats agreed to ease credit slightly.

Failure to obtain approval of the program in parliament and in labor union councils would bring down the government. The coalition parties probably can exercise enough self-discipline to get the measures through parliament, but labor union cooperation is less certain. The unions may go along for the time being, but if prices continue to rise rapidly as taxes cut more deeply into income, their cooperation almost certainly will evaporate.

Because Italians are past masters at income tax evasion, the government is relying most heavily on increases in value added and other indirect taxes. While some of the tax measures—such as a hike of 25 cents per gallon in the gasoline tax—have the particular aim of cutting the trade deficit, most are designed to reduce over-all consumer demand.

A key aspect of the Christian Democrats' agreement to ease credit will be long-term loans to small- and medium-sized companies and loans to finance economic development in the South. These loans are to be covered by a \$3-billion sale of special bonds to commercial banks. Minister of the Treasury Emilio Colombo reaffirmed Italy's commitment to IMF credit ceilings.

The tax package is expected to trim domestic demand by about 3 percent over 12 months. GNP growth probably will slow to 3-4 percent in 1974, compared with 5.4 percent in 1973. The growth rate will be even lower in 1975 when the full impact of the austerity program is felt.

The anticipated drop in domestic demand will reduce imports by about 10 percent, after a lag of a few months. Many import orders already

have been placed, and time is needed for the direct tax measures to have their full impact. Together with some small effects from the import deposit scheme, the austerity program should hold Italy's trade deficit to about \$10.5 billion in 1974, instead of the \$12 billion implied by trade flows so far this year.

Even after adjusting the trade account for the favorable impact of the austerity program, the current account for 1974 will be about \$7.5 billion in deficit. Italy's traditionally large surplus on net services and transfer payments has been decreasing in recent years, largely because of hidden capital flight and increased interest payments. Heavy net capital outflows could boost the balance-of-payments deficit to an estimated \$10 billion.

The balance-of-payments deficit expected in the second half of 1974 will require additional foreign borrowing. Rome has a meager \$2.2 billion in available foreign exchange, and support of the lira has been costing \$1 billion monthly. Italy still has large reserves of gold, but it would sell substantial quantities only as a last resort. The gold could be used as collateral for loans if the parties could agree on price and terms. The \$4 billion that the Bank of Italy lined up under short-term swap arrangements with other central banks cannot be drawn because the banks fear, justifiably, that they would not be repaid.

In coming weeks, Italy will have to let the lira's value plummet, impose additional import controls, or obtain new foreign loans. The government will try to avoid the first two options. A plunge of the lira would be opposed by the Socialists and trade unions because of its inflationary effects.

Further import controls would be objectionable to the EC and GATT and would violate the terms of Italy's IMF standby credit. By giving some assurance that Italy is finally starting to put its house in order, the austerity program should help Rome find new funds abroad, especially if gold is offered as collateral.

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USSR

SPACE STATION IN ORBIT

The Soviets placed a large Salyut space station in orbit this week. The spacecraft, announced by TASS as Salyut 3, was launched from Tyuratam on June 24 using an SL-13 booster. The space station's systems appear to be operating normally.

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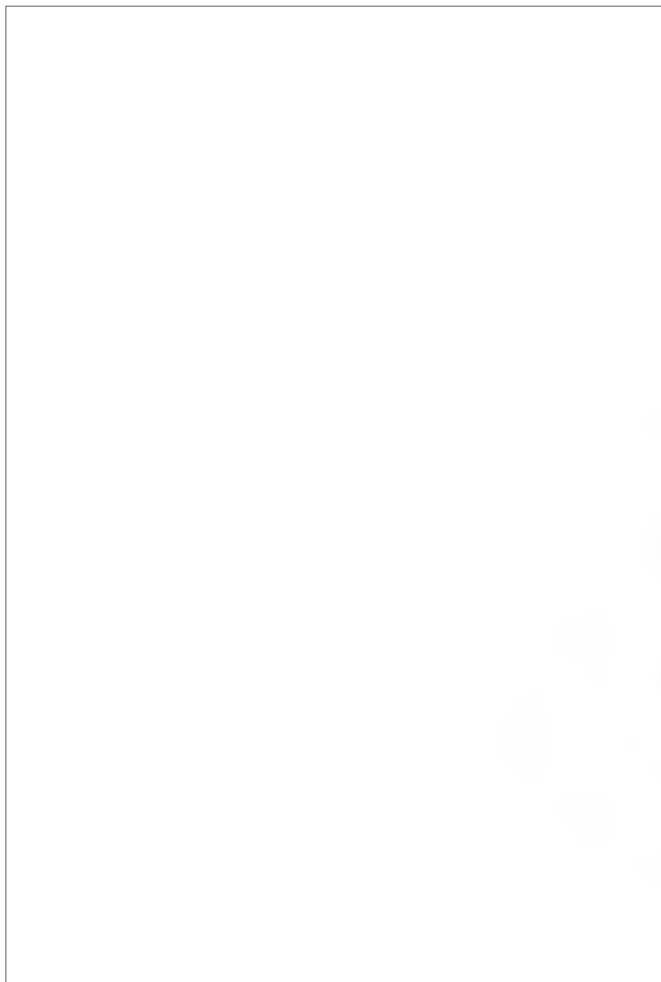
The Soviets will probably orbit a Soyuz spacecraft with two cosmonauts aboard to rendezvous and dock with the Salyut. Soviet space support ships are en route to monitoring stations in the Pacific, and others are already in position in the Atlantic to support a manned mission. The launch could occur within less than a week and, if so, would coincide with the President's visit to Moscow.

The only previous Soyuz-Salyut mission occurred in June 1971 when Soyuz 11, carrying three cosmonauts, docked with Salyut 1. The cosmonauts remained aboard the space station for nearly 23 days, performing a wide variety of experiments in biomedicine, earth observation, astronomy, and astronavigation. They perished when a leak developed in their Soyuz spacecraft while re-entering the earth's atmosphere.

Four Salyut space stations have been launched since 1971. Two of these, Salyut 2 and Cosmos 557, developed malfunctions while in orbit and were never visited by cosmonauts. A third failed to achieve orbit. The Salyut 3 is another step toward the development of large space stations in earth orbit that can be manned by successive crews for long periods of time.

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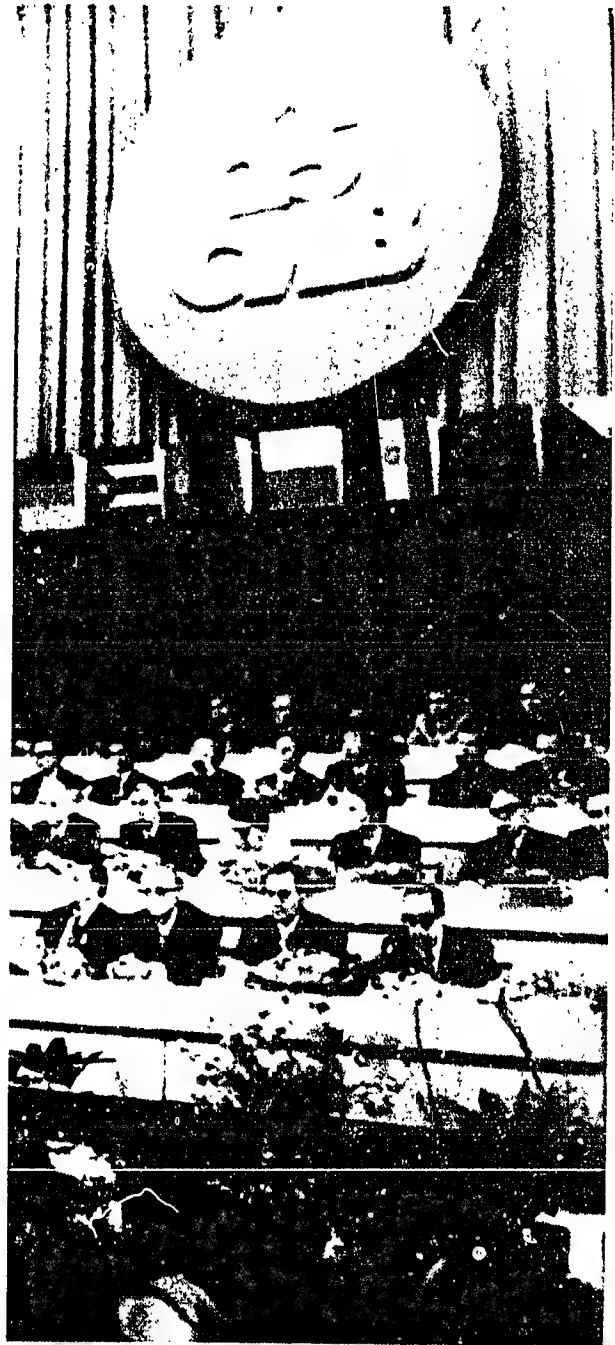
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CEMA: SOFIA MINISTERIAL ENDS

Soviet Premier Kosygin and government leaders from the USSR's eight full CEMA partners and from Yugoslavia met in Sofia from June 18 to 21 for the 28th ministerial session of the Council of Mutual Economic Assistance.

As expected, the participants focused on the development of energy and raw material resources. The European members of CEMA gave final approval to the multilateral exploitation of Soviet natural gas deposits at Orenburg and construction of a pipeline from there to Eastern



CEMA session in Sofia

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Europe. They also agreed "in principle" to develop Cuban nickel mines.

Earlier preliminary agreements on the exploitation of Soviet iron ore resources at Kursk and the construction of a new power line to Eastern Europe were mentioned only briefly, suggesting that further details have yet to be worked out. Hungarian Premier Fock said the session heard a proposal to build two more major power lines connecting the USSR and Eastern Europe. His Czechoslovak counterpart said that the Soviets had "clarified" the amount of raw materials and fuel they would deliver, and the terms of delivery, for the next five-year period.

The participants announced that the "first stage" in coordinating national economic plans for 1976-1980 was completed, but gave no indication of progress on the thorny problems of detailed coordination of plans and revision of intra-CEMA foreign trade prices. Similarly, there was no evidence of movement on financial reform issues. After the session, CEMA Secretary General Fadeyev rejected any quick movement toward intra-CEMA convertibility of the transferable ruble, CEMA's accounting unit.

The conferees may have decided what moves CEMA will make to establish a dialogue with the EC. Although the communique ignored the matter, Fadeyev did say after the session that "regular contacts" between the two organizations would be a "great contribution to lasting international detente."

The Romanians apparently restated their views on economic integration and, judging by their rhetoric before the meeting, pushed for more generous treatment from their developed CEMA partners. Bucharest's case was no doubt poorly received. A Hungarian statement during the session noted icily that it was time to move from general principles to specific deeds. The Romanians signed all but one of the agreements concluded at the session, abstaining from an agreement on standardization.

Bucharest will not fully participate in the construction of the Orenburg gas line.

CSCE: PLODDING THROUGH

The European Security Conference has plodded through another indecisive week, ending whatever faltering hopes the Soviets and others had that the concluding phase could be held in July. The Soviets now seem reconciled to holding the final stage later this year.

The conference is still stalemated over the issues of "freer movement" and military-related "confidence-building" measures. Two weeks ago the Soviets made three concessions in these areas to demonstrate that they are still negotiating in good faith. They accepted a reference to "subscriptions" in the text on access to printed information, and they also agreed to increase from 50 to 100 km the depth of the frontier zone requiring notification of military movements, and the time of advance notification from seven to ten days.

The Soviets have shown little inclination to compromise on other aspects of the "freer movement" issue. They continue to call for specific references to respect for national laws and customs—the formula they have used to oppose Western efforts to increase non-governmental human contacts.

The net result is that the two sides are still far apart. The West European participants will be reluctant to let the conference conclude at all without significant Soviet concessions on the freer movement issue. Some Western delegates are already considering adjourning the conference for an indefinite period.

The Soviets may now be hoping that some sort of breakthrough on CSCE will occur during President Nixon's visit. The key question is what Moscow will do if the summit fails to give new impetus to CSCE.

The Soviet desire for a top-level meeting in the near future is still strong and was endorsed by most of the leaders in a series of Supreme Soviet election speeches earlier this month. Moscow is aware, however, that the West has sought negotiating leverage from the Soviet interest in an early and successful CSCE, and it will give ground grudgingly on the unresolved issues.

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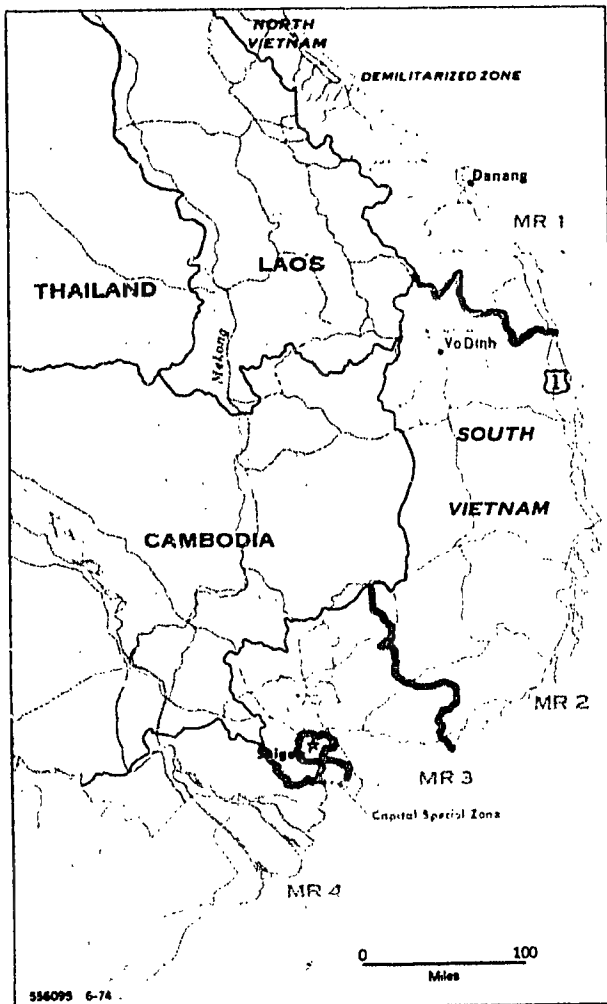
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VIETNAM

THE FIGHTING GOES ON

Military activity this week reached a high point for the year in the northern provinces, particularly in Thua Thien and Quang Tin. The communists also increased their sapper attacks against fuel and ammunition depots and the shelling of government positions on a countrywide basis.

Combat in the central provinces picked up slightly during the week but still remains rela-

tively low. The Military Region 2 commander recently suspended the stalled government campaign against the major communist supply area at Vo Dinh north of Kontum City. He also shifted many of his combat units in the highland provinces. The new division commander in Kontum is now applying new tactics against the effectively dispersed North Vietnamese artillery sites and defenses and hopes to regain the initiative.

The government operation to recapture two psychologically important outposts north of Saigon in Binh Duong Province has been temporarily halted in order to rotate forces and rebuild ammunition stocks. East of Saigon, government troops have been unsuccessful in easing pressure on national Route 1. Although this key artery between the coastal provinces and Saigon is again open, traffic is increasingly harassed.

The number of incidents in the delta provinces returned to a fairly low level this week—in keeping with the monthly cyclical pattern of communist activity there. The major battlefield in the delta—along the Cambodian border—remained relatively quiet.

IMAGE POLISHING

Hanoi has been trying to polish the image of the Viet Cong's Provisional Revolutionary Government as a legitimate government ever since the cease-fire. More than 40 countries—principally the communist states and some left-leaning African nations—now recognize the Provisional Revolutionary Government, but Hanoi has failed to crack the ranks of either the industrialized non-communist states or Vietnam's immediate neighbors in Southeast Asia. The Vietnamese communists have had to settle for token gestures of recognition to salvage any gains at all.

The Vietnamese communists hoped that the recent French decision to upgrade the Provisional Revolutionary Government's information office in Paris to mission level would serve as a catalyst to entice other Western nations to follow suit.

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their gesture was a minimal one, required by France's unique position as the host to the Vietnam peace negotiations, and not a precedent for others to follow. Specific demarches to Canada, Belgium, and the Netherlands appear to have failed, and even Sweden, long sympathetic to the cause of the Vietnamese communists, has turned down, at least for the immediate future, personal appeals by Hanoi's Premier Pham Van Dong to recognize the Provisional Revolutionary Government.

The Vietnamese communists have not fared any better in extended negotiations with Japan over the exchange of ambassadors between Hanoi and Tokyo. The talks have been hung up on two issues: Japanese economic aid for North Vietnam and recognition of the Provisional Revolutionary Government. As Hanoi's need for foreign aid has increased, its determination to advance the Provisional Revolutionary Government's diplomatic interests appears to have waned. Japanese negotiators are now confident that Hanoi is prepared to jettison the recognition issue and settle for a compromise on aid levels.

Hanoi's efforts on behalf of the Provisional Revolutionary Government, however, may get a

more sympathetic hearing elsewhere in Asia. The new deputy prime minister of Australia, Jim Cairns, is a long-time sympathizer who argues that the provisional government, under the Paris agreement, is entitled to equal status with the Saigon government. So far, Australia's Labor government continues to deny formal recognition, but some gesture—probably support for seating at international conferences—may eventually be made.

Hanoi has been turning the screws hardest—and most effectively—closer to home in Laos. Initially, Prime Minister Souvanna succeeded in tabling a communist demand for recognition at a cabinet meeting on June 12 and reportedly received the King's blessing for a continuation of Vientiane's policy of recognizing Saigon and ignoring the Viet Cong. Following subsequent backstage maneuvering, however, he is now privately discussing the possibility of reducing Saigon's representation to charge status and granting some—perhaps informal—representation to the Provisional Revolutionary Government and also to Sihanouk's exile "government." With continued communist pressure on this issue certain, at least some bow in this direction appears likely.

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AUSTRALIA: MODERATION FOR NOW

The moderate tone of Deputy Prime Minister Cairns' public comments since his elevation to the number two government post two weeks ago suggests that his broader responsibilities have influenced him to mute his criticism of the US for the time being.

Cairns has been in the forefront of Australian leftists agitating for the early removal of US defense and scientific installations in Australia, but he now implies that he will not in the near future use his new position toward that end. He has reiterated his opposition to the presence of these facilities over the long term, but expects improvements in technology to eliminate the US need for them before too long.

In the past, Cairns focused his most vehement criticism on US Vietnam policy. Last week he told the press that this issue had lost its importance to him and that in his new government role he would now concentrate on Australia's internal problems. Cairns will, in addition to the deputy prime ministership, again hold the international trade portfolio in the cabinet, and he may wish to expand his influence in domestic economic policy. Now almost 60, Cairns may still harbor the ambition to become party leader and prime minister.

Cairns has tried, since becoming deputy prime minister, to give the impression that he is selective rather than automatic in embracing leftist aims. He has, for example, advocated recognition of the Viet Cong provisional government and Cambodia's Sihanouk—but not the Lao or Cambodian Communists. He professes to be as opposed to Chinese nuclear testing as to French testing in the Pacific and says he will raise the issue when he visits Peking later this year. In expressing his foreign policy views, Cairns modestly says he is speaking for himself, not the government, but his new position tends to give his views greater weight.

Cairns may calculate that since there are no foreign policy issues of strong interest to him at this time, he can afford to adopt a responsible pose in keeping with his higher government position. Considering his strong sense of nationalism,

however, he will be likely to resume criticism of US policies any time they strike him as inimical to Australian interests. In particular, should he conclude over the next few months that the US is giving no thought to the eventual removal of its bases from Australia, he may well renew his agitation against them.

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CHINA

POSTER POLITICS

The walls in one section of Peking were freshly papered this week with new political posters. Unlike their predecessors, the new tracts consist largely of personal grudges and graphic accounts of alleged physical abuse suffered by the authors. The focus is definitely local. In keeping with a Central Committee directive issued last month, representatives from several provinces have come to Peking to air their grievances in posters.

Two Politburo members attacked in the initial round of posters earlier this month—one by name and the other by thinly veiled innuendo—made public appearances this week. The posters have apparently had little or no effect on their political standing. Moreover, an article in the current issue of *Red Flag*, the party theoretical journal, strongly suggests that at least some of the officials criticized in posters are wrongfully attacked. The article warns against mistaking "friends" for "enemies" and "hurting our comrades."

The same article encourages the expression of "correct criticism," and there seems little doubt that the party Central Committee—not the poster critics—will ultimately decide the fate of provincial officials currently under attack. Recent Central Committee directives have in fact taken a stand on some of the provincial leaders named in posters. One directive supports the first party secretary in Szechwan Province and another criticizes the top official in Kiangsu Province.

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1973 TRADE BOOM TO CONTINUE

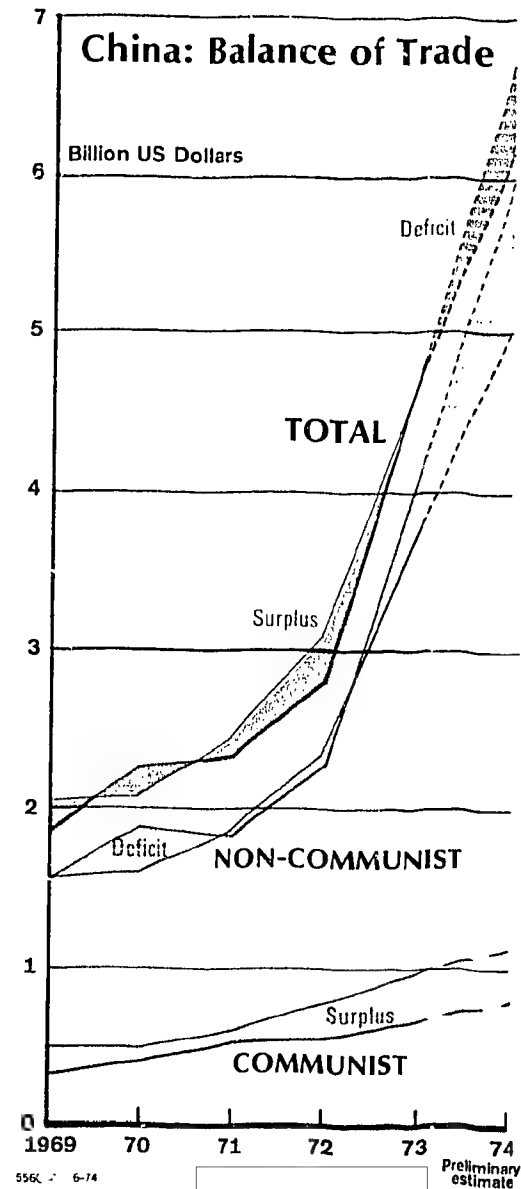
Pushed by soaring world prices, currency revaluations, and a rising volume of imports and exports, the dollar value of China's foreign trade in 1973 increased by 60 percent to approximately \$9.4 billion. This year, trade will probably increase another 30-40 percent, approaching \$13 billion.

China's trade deficit last year with the non-communist world was \$425 million, and it is expected to reach \$1 billion in 1974. To help cover these deficits, Peking has relaxed its conservative financial policy and greatly expanded the use of short- and medium-term credit. At the same time, China has stepped up efforts to boost hard currency earnings from commodity exports and services. Petroleum exports, only \$35 million in 1973, will probably exceed \$300 million this year and could earn \$1 billion annually within the next few years.

China's recent surge in imports is aimed at overcoming agricultural shortfalls and boosting industrial development. Imports of grain, sugar, cotton, and vegetable oils will probably increase from a record \$1.3 billion in 1973 to about \$2 billion this year. Roughly half of China's agricultural imports will come from the United States.

Machinery and equipment orders from the West in 1973 totaled almost \$2.5 billion, including \$1.2 billion-worth of complete industrial plants from Japan, Western Europe, and the United States. New orders for machinery and equipment are strong, despite a growing debate in China over the dangers of reliance on foreign equipment and technology.

Trade with the non-communist world will continue to account for 80 percent or more of China's total trade. Japan will remain the leading partner with two-way trade reaching about \$3 billion. The US, now China's number two trading partner, will run up a surplus that is likely to exceed \$1 billion on a total trade of \$1.2 billion. Trade surpluses with Hong Kong and the less developed countries will help offset China's large deficit with the developed West.



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President Peron and wife appearing earlier this month

ARGENTINA: PERON ILL AGAIN

President Juan Peron's incapacitation with another bout of "flu" suggests that his health is continuing to deteriorate.

Although official sources have described the illness as "mild" and stated that the President could handle affairs of state from his residence, his condition apparently is more serious than government spokesmen are willing to admit. Sources close to Peron's inner circle have told the US embassy that while Peron's condition is not critical, there have been respiratory complications and Peron will have to maintain a reduced schedule for an indefinite period.

The seriousness of Peron's condition was pointed up by the sudden return to Argentina of Peron's private secretary, Jose Lopez Rega, who had been accompanying Vice President Peron on her trip to Europe. Mrs. Peron also reportedly intends to cut short her trip after stops in Italy, Switzerland, and Spain. US embassy sources believe this is a precautionary move and that the government is trying to avoid alarming the public.

To some extent, Peron's most recent sickness can probably be attributed to the strains imposed on him by his heavy schedule during the past few weeks. In addition to coping with Argentina's deteriorating economic situation, Peron addressed a massive outdoor Peronist rally, made several speeches to key economic groups, and met with visiting foreign ministers of the La Plata basin countries. He had already complained of not feeling well after his trip to Paraguay earlier this month.

All of these demands on Peron's energies have undoubtedly taken their toll. The 78-year-old President had hoped to travel to Spain for medical attention and rest during the worst of Buenos Aires' winter, but political pressures and problems at home have made him reluctant to leave.

Peron's latest illness will probably fuel renewed discussion on succession. [redacted] exploratory talks have been undertaken by civilian, business, and military circles to formulate political plans for the post-Peron era. Some armed forces sectors favor an expanded military role in the government succeeding Peron, but most active duty officers are resisting the efforts of a few retired officers to gain commitments of support.

Because of their strong reluctance to assume the responsibility of governing, the majority of the armed forces favors a strict constitutional

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[redacted]

succession, with the military backing Vice President Maria Estela Martinez de Peron or Senate President Jose Allende. Although officers are concerned with the course of the Argentine economy and Peron's lack of progress against the terrorists, they would be reluctant to take the reins again unless widespread violence broke out after Peron's death. [redacted]

leave the presidency next year for health reasons.

[redacted]

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Morales Bermudez appears to be in no danger of being ousted as was Vargas, since his base of support is more widespread. Radicals in the cabinet and in the army, however, are likely to persist in their efforts to reduce his influence. In the past, Velasco has felt that Morales Bermudez is the best qualified to provide stability and durability to the revolution. Recent events, however, suggest that the President places more importance on instituting further revolutionary change than on maintaining military unity and achieving the highest degree of political stability.

[redacted]

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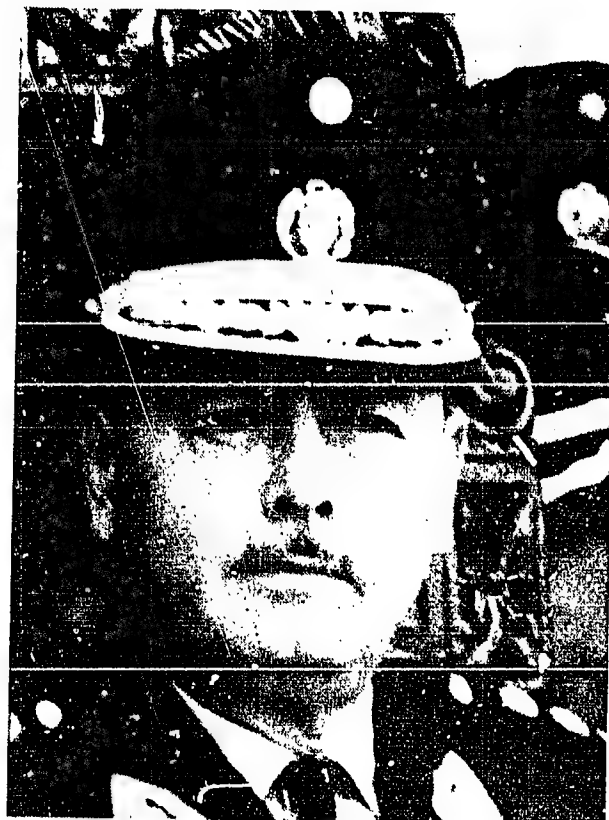
PERU: A SHIFT TO THE LEFT

The rising tensions caused by the forced retirement of Navy Minister Vargas last month appear to have subsided, but the six-year-old military regime now is likely to shift further leftward.

The initial round of resignations by navy officers who shared Vargas' moderate views appears over; Navy Minister Arce reportedly has convinced other officers to retract their resignations. President Velasco has demonstrated his considerable military support, but tensions below the surface will continue to have an unsettling effect on the regime.

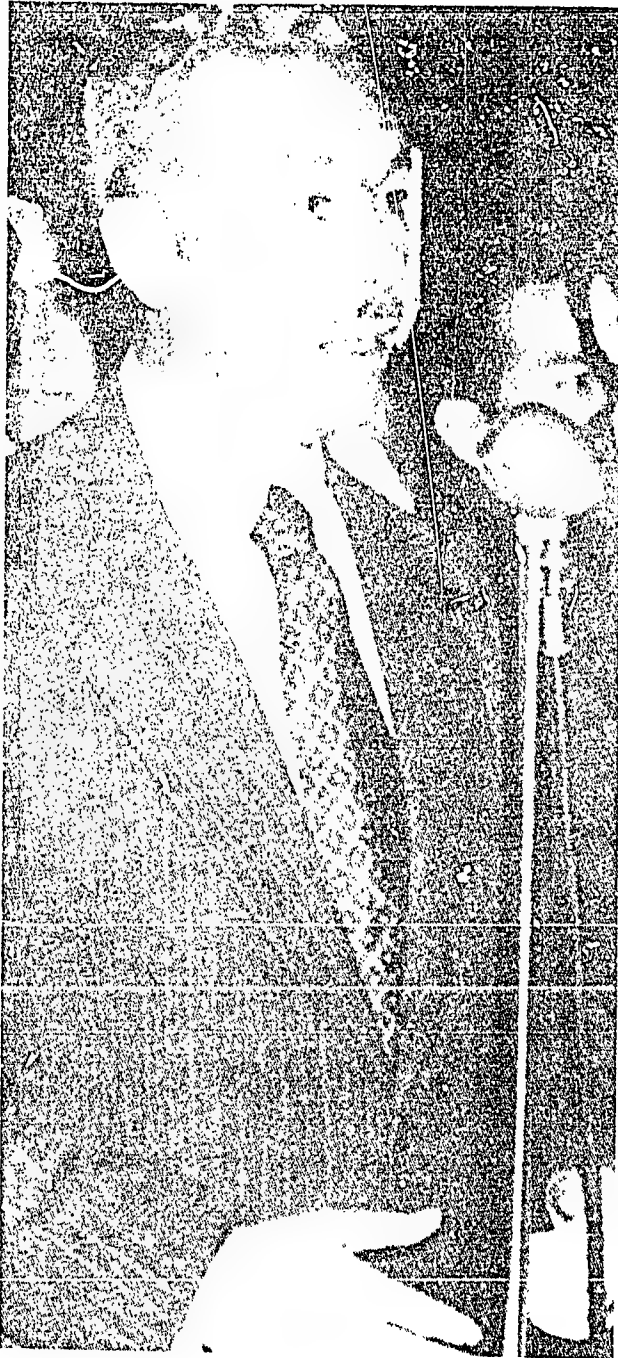
It is the more radical government leaders who are likely to profit most from the recent military split, even though Velasco probably did not specifically intend this. The new navy minister has taken a line in strong support of the President and is unlikely to oppose the radicals as did Vargas. The radicals also are likely to be encouraged by two recent government actions: the closing of a leading non-leftist magazine and the outlawing of a major non-leftist political party. Further moves against the non-leftist news media appear certain. In addition, Velasco seems more determined than ever to implement the social property system, which will significantly increase government control of industry. Radicals have hotly defended this program.

The succession problem is likely to be affected by the outcome of the military split. In January, Army Chief of Staff Morales Bermudez is scheduled to become prime minister, a likely post from which to succeed Velasco, who may



Velasco

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Kjell Laugerud

GUATEMALA: MORE OF THE SAME

On July 1, the rightist, two-party coalition that has governed since 1970 will receive another four-year lease on power when Kjell Laugerud, a 44-year-old retired general, fierce anti-communist, and friend of the US is inaugurated as president. Despite campaign promises to bring about modest social and economic change and to deal with political dissent legally, his government's policies, direction, and methods are not likely to be much different from those of his predecessor.

The new cabinet, announced on Monday, is basically conservative. Laugerud chose close friends to head the key defense and government ministries and technically competent, respected men for most of the other positions.

Laugerud achieved his victory in the election last March through blatant vote rigging—excessive even by Guatemalan standards. Protests of the fraud by the defeated Christian Democratic Party have been to no avail, and it seems resigned to Laugerud's accession. The defeated candidate, now military attache to Spain, is all but forgotten. The army was initially dissatisfied with the government's conduct, but now appears fully united behind the president-elect. The government itself has eased its harassment of opposition leaders, although political assassinations have continued in the interior.

Nevertheless, Laugerud will start from a weak position. The Christian Democrats are still angered at having victory stolen from them, and their disgruntlement is likely to smolder for some time. The party believes that the violence directed against it in the countryside is part of a government effort to cripple if not eliminate it as a viable opposition group. Its leaders plan to organize against government attacks and hope over time to generate public resistance to the Laugerud government. Moderation is a scarce commodity in Guatemalan politics, however, and the conservative Laugerud is likely to react with strong countermeasures when confronted with dissent.

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[REDACTED]

Laugerud will have to grapple with serious economic and social problems inherited from the outgoing administration of President Carlos Arana. Although the middle class is expanding, wealth and power still belong to only a small segment of society. Many in the lower class live on the borderline of poverty and starvation. Increasing inflation is worsening the economic picture. Tax law revisions—periodically proposed, but invariably defeated or watered down by business interests—are essential to raise badly needed revenues for the government.

Laugerud will also have to devote considerable time and energy to blunting the influence of his vice-president, Mario Sandoval. Sandoval, an extreme rightist, an advocate of political repression and violence, and an ambitious leader of one half of the governing coalition, will attempt to have a hand in most policy decisions. In dealing with him, Laugerud will be hampered by the knowledge that he owes his election to Sandoval's skill in engineering the vote rigging. To Laugerud's advantage is his support from the army, which is almost unanimous in wanting to minimize Sandoval's influence. Laugerud has already won an important bout with Sandoval over the choice for president of Congress, but this struggle is likely to be only one of many, as both men try to assert their will.

The new president's relationship with Arana, who will be the only ex-president in recent times to remain in the country after his term in office, could be delicate. Some observers believe Arana will try to maintain a position of power by preserving the loyalty of senior army commanders. If Arana is successful in this, Laugerud will be dealing with more than just a consultant on policy matters.

Laugerud's main concern in external affairs will be the perplexing problem of Belize, the neighboring British self-governing colony that Guatemala claims as its own territory. Belize wants independence, coupled with a defense guarantee from the British, but London wants to withdraw completely. Its dilemma is how to prevent a Guatemalan take-over of an independent Belize while avoiding the albatross of a defense

guarantee. Laugerud professes a hard line on Belize and would probably intervene, by force if necessary, should the UK give Belize independence without reaching an accommodation with Guatemala. His preferred course, however, is probably to emulate his predecessors—procrastinate for four years and pass the problem unresolved to the next president.

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BRAZIL'S AFRO-LUSO DILEMMA

Brazilian diplomatic skill is currently being tested by developments in Portugal and its African colonies. The new situation presents both opportunities and pitfalls.

Brazil, linked to both sides by history, race and culture, sees an opportunity to make political and economic gains by helping the mother country reach a settlement with its overseas possessions. The Foreign Ministry's optimum goal would be to demonstrate Brazil's ability to serve as a bridge between the West and the Third World.

Complicating the situation is Brazil's somewhat strained relationship with Portugal. Traditionally, relations with Lisbon have been good, and Brazilians feel genuine affection toward the mother country. In fact, a 1971 treaty gives virtual rights of citizenship to nationals of one country residing in the other. Recent developments, however, have caused problems that point to a downgrading of ties with Portugal.

Even before the Lisbon coup, Brazil had apparently decided to strengthen ties with black Africa, an area of interest to Brazil since the colonial period. In addition to the attraction of Angolan oil and Mozambican copper and coal, Portuguese African ports could provide access routes for Brazilian products to areas of high

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purchasing power, such as Rhodesia and South Africa. Brazil's interest in Africa may have triggered fears in Portugal that Brasilia was intent on supplanting Lisbon there. Last year Brazil refused to sell Portugal armored vehicles that might have been used in Africa, despite Brazil's great need to expand exports. This year, Brazil displeased the Portuguese by sending as ambassador a personal enemy of the new Brazilian president.

At present, Brasilia is distrustful of the new junta, which is allowing socialists and communists to re-enter public life, something the Brazilian generals would not even contemplate. Portuguese junta member Galvao de Melo accomplished little of substance during a recent visit designed to obtain Brazilian support. Moreover, Brasilia is anything but certain just what policy line the

Portuguese will ultimately take toward their overseas territories.

For the moment, Brazil is making no commitment so as to avoid as long as possible completely alienating either side. In fact, the Foreign Ministry has deftly turned aside an Organization of African Unity call for Brazilian mediation by responding that, while Brazil is prepared to cooperate, it is not yet ready to serve as formal mediator.

If the African colonies persist in their demands for independence, Brazil may eventually feel compelled to come down on their side. This position would reassert Brazil's anti-colonial, Third World credentials, which its African and Middle East oil suppliers are surely watching.

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Weekly Review

Special Report

Nationalist China Revisited

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Nº 407

June 28, 1974

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Chiang Ching-kuo

*Nationalist
China
Revisited*



Chiang Kai-shek

The Nationalist regime on Taiwan has profited from the island's spectacular economic development, stable political institutions, and close relationship with the US to solidify its control. International political and economic developments, however, such as the rapprochement between the US and Peking and the international oil crisis, have led some on Taiwan to question the island's prospects. Increasing political isolation, the prospect of further normalization of relations between the US and Peking, and continued buffeting of the island's economy by world economic developments will confront the Nationalist leadership with increasingly difficult problems that must be handled with limited political and economic resources.

One of the Nationalist government's best assets is the firm leadership supplied by Premier Chiang Ching-kuo. The Premier has been de facto head of the regime since his father's illness two years ago. Broadly experienced, with an extensive network of supporters throughout the party, government, and army, Chiang Ching-kuo so far has succeeded in coping with Taiwan's international isolation. Increasing concern over his economic, and some of his international policies, however, has contributed in the past few months to the first serious, albeit muted, criticism of his leadership.

Special Report

June 28, 1974

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The Nationalist regime in Taiwan is counting on continued economic prosperity, stable political institutions and continued close relations with the United States to help prolong its 25-year hold on the island. These assets are offset, however, by potential weaknesses in the economy, long-range morale problems, and a widespread belief that the all-important relationship with Washington will be further eroded.

An encouraging sign of the Nationalists' prospects for political survival has been the regime's ability to weather successfully a change in leadership. Since retreating to Taiwan in 1949, the Nationalist regime had been dominated by President Chiang Kai-shek. In the summer of 1972, serious illness and the vicissitudes of age—he was 85—forced President Chiang out of active political life. He made no public appearances and received no high-level visitors between July 1972 and late March 1974, when he bade farewell to the departing US ambassador. Although he is no longer ill, he appears to be only casually interested in public affairs.

Chiang Ching-kuo

Since mid-1972, Taiwan has been under the leadership of the president's son, Premier Chiang Ching-kuo, who had been groomed by his father in a series of increasingly responsible positions. He maintains a busy schedule, [redacted] and appears fully in command of political power. The Premier, for example, made all the major decisions in Taiwan's confrontation with Japan last April over Tokyo's civil air agreement with Peking.

There's more to Chiang Ching-kuo's political authority than the inheritance of his father's mantle and his constitutional powers as Premier. Chiang Kai-shek still provides a psychological buttress, but Ching-kuo's authority rests on the network of supporters built up over decades of work at the heart of Nationalist politics. This network is a major asset in a society where personal loyalties remain important.

Since becoming Premier, Chiang Ching-kuo has attempted to consolidate further his political

position. As Premier, he selected, subject to his father's approval, the membership of the Executive Yuan—the national cabinet—and brought young technicians into the middle reaches of the government. They owe their status to him and have a vested interest in his continued political success. Older associates of the president are slowly being shunted aside.

To improve his government's image, Premier Chiang has pushed hard to combat corruption, not sparing those having high-level connections with his father's regime. He has tried to make the administrative apparatus more efficient and to weed out the incompetent, the no longer useful, or, in exceptional cases, the potentially hostile.

To strengthen his position in the army, the Premier has instituted a system of rotation among unit commanders and political officers, and personally approves all appointees from command down to the regimental level. The new minister of national defense, General Kao K'uei-yuan, reputedly is a Chiang Ching-kuo man.

The Premier also has his supporters planted in important Kuomintang offices. Although the party is more a tool of power than a source, control of it gives Chiang Ching-kuo dominance over the island's only major political organization. Almost without exception, the standing committee endorses the decisions of the Premier, as they did those of his father. Chiang Ching-kuo holds a seat on the Central Standing Committee, and his close associate, Li Huan, heads the party organization department—the main lever of power in the party. The reorganization of the party central headquarters in the spring of 1972 inevitably entailed some redistribution of power within the party hierarchy—generally to Ching-kuo's advantage. The Premier also played a major behind-the-scenes role in selecting the candidates for election to the Central Standing Committee in March 1972. Chiang Ching-kuo is now second only to his generally inactive father in the official party hierarchy.

In consolidating his own position, the Premier has sought the support of the Taiwanese, in part by bringing more of them into political

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life. Since the Kuomintang retreated to the island in 1949, mainlanders have held most of the high-ranking posts in the party, the civil bureaucracy, and the military service. A Taiwanese did not reach the rank of ambassador in the foreign service until 1972. The new cabinet that accompanied Chiang Ching-kuo into office in May 1972 contained an unprecedented number of six Taiwanese, double the number in the previous cabinet. For the first time, a Taiwanese became a vice premier, while another was made governor of the province.

Some Taiwanese intellectuals and politically conscious young businessmen dismiss these moves as meaningless sop. Mainlanders still hold the most important positions in the government, security apparatus, party, and army. Those Taiwanese who have achieved high office not only occupy the less vital offices, but also have been involved with the Kuomintang for almost all of their political lives and are carefully watched by mainland subordinates. Some are "half-mountamen" who were born in Taiwan but spent a great part of their lives in the mainland.

Mainlander-Taiwanese Tensions

Nevertheless, mainlander-Taiwanese animosities have become less intense. Differences between the two groups have become blurred through intermarriage and common cultural experiences. As Taipei's diplomatic isolation deepened, increasing concern about Taiwan's future provided impetus for greater cooperation. Neither group wants to come under the domination of Peking. The mainlanders are interested in maintaining their privileged political status on an independent Taiwan. The Taiwanese business community, which controls the private sector of the island's economy, is equally determined to maintain the capitalistic economic system that has made it prosperous. Even though Taiwanese appointments to national ministries are largely cosmetic, the Taiwanese do have a stake in the island's political life and are prominent in local-level politics.

The Kuomintang's iron grip on Taiwan's political process, reinforced by a usually efficient

security organization and backed up by martial law legislation, makes organized political opposition hazardous. Most politically ambitious Taiwanese have made their peace with the party because there is no other choice. Many young Taiwanese politicians believe that time is on their side, not only because they outnumber the mainlanders, but because of Chiang Ching-kuo's need to placate the Taiwanese in order to secure political support and stability in the uncertain days ahead.

Once hopeful of making Taiwan a republic with no ties to the mainland, the Taiwan Independence Movement has become badly fragmented and is poorly led. Improved relations between the US and China and Japan's recognition of China ended the movement's hope of support from Washington and Tokyo. Visits to Peking by the movement's members reportedly have resulted only in communist admonitions that the future of Taiwan is within a united China. China is interested in the Taiwanese independence movement mainly for its potential nuisance value against the Nationalist regime.

The Economic Picture

The importance of the Taiwanese within the island's economy involves them in one of the most sensitive areas of Nationalist policy. Business support and confidence in the regime's future are important elements in maintaining stable control of the island. So far there has been no indication that Taipei's diplomatic reverses and anxiety about relations with the US have led to a lack of business confidence, even though many in Taiwan, both in and out of government, now regard US-Chinese diplomatic relations as only a matter of time. But if prosperity has helped induce political apathy useful to the regime, an economic downturn could spell trouble. Certainly, the economy is still providing a standard of living for the average citizen far surpassing that on the mainland. Some of the bloom, however, has come off the rose. Like other developing countries, Taipei has been hard hit by the sharp increases in prices of oil, basic commodities, and manufactured goods that Taiwan must import to continue its industrial

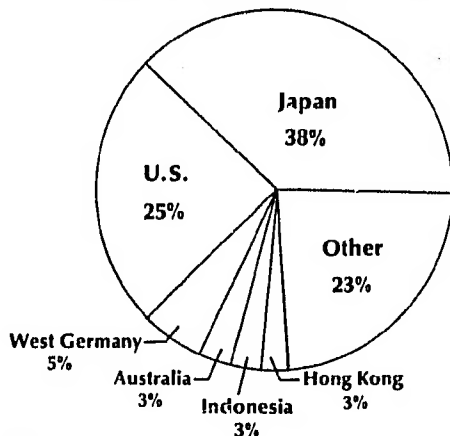
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Imports to Taiwan in 1973

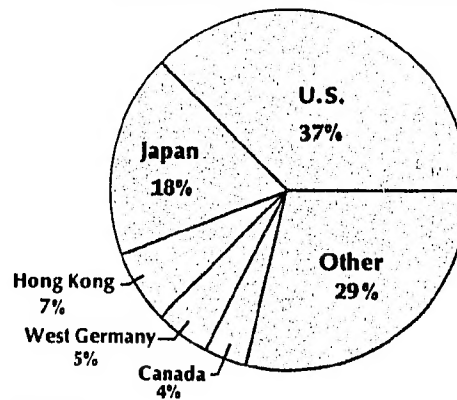
Total=\$3,792.5 (million U.S. dollars)



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Exports from Taiwan in 1973

Total=\$4,483.4 (million U.S. dollars)



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development. Nationalist policy makers were already concerned about inflation last year, even before the oil crisis, when inflation averaged 10 percent. By last fall, the prices of some items, including daily necessities, were 30 to 50 percent over those prevailing at the beginning of the year. As 1974 began, inflation showed no sign of abating; indeed, the round of crude oil price hikes that had just occurred promised to aggravate inflationary pressures.

In January 1974, the government announced sweeping economic stabilization measures, including large price increases for such basic needs as petroleum, electricity, and transportation, as well as a tight money policy. To offset the increased cost of living, a 10-percent pay raise was granted to civilian and military government personnel with a 40-percent rise to follow in July. By late May, there were some indications that inflation may have begun to ease as wholesale and consumer price indexes in April dipped from March levels. The implementation of the economic stabilization program, however, did not eliminate concern within official and business circles about Premier Chiang's ability to handle economic problems. The tight money policy threatens bankruptcy for many small and medium firms, and the Premier may be unable to resist

pressures to loosen the reins. In fact, Taipei has decided to extend credits to small- and medium-sized firms to finance imports of vital raw materials.

The International Problem

Continued economic prosperity and political stability are closely bound up with problems of foreign policy. Taiwan still depends heavily on export growth, imported raw materials and industrial machinery, and continued foreign—particularly US—investment for sustained economic growth. But the series of political reverses suffered in the last four years—expulsion from the UN and its affiliated organizations, and the massive shift by other countries to recognize China—call into question the long-term international position of the island and the regime. Diplomatic representation has been reduced to 35 countries, mostly in Africa and Latin America, as the number of governments recognizing China increased from 45 in 1969 to 90 by mid-1974. The erosion is continuing. Taipei is probably correct in fearing that Malaysia's recognition of China in May will be followed by the Philippines and Thailand. In Latin America, Brazil and Venezuela are actively interested in expanding contacts with Peking.

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Taipei has been able to minimize the effects of growing political isolation by adopting a more flexible approach, including a de facto two-China policy. More importantly, essential economic ties have been preserved with major trading partners that have switched their diplomatic recognition to Peking.

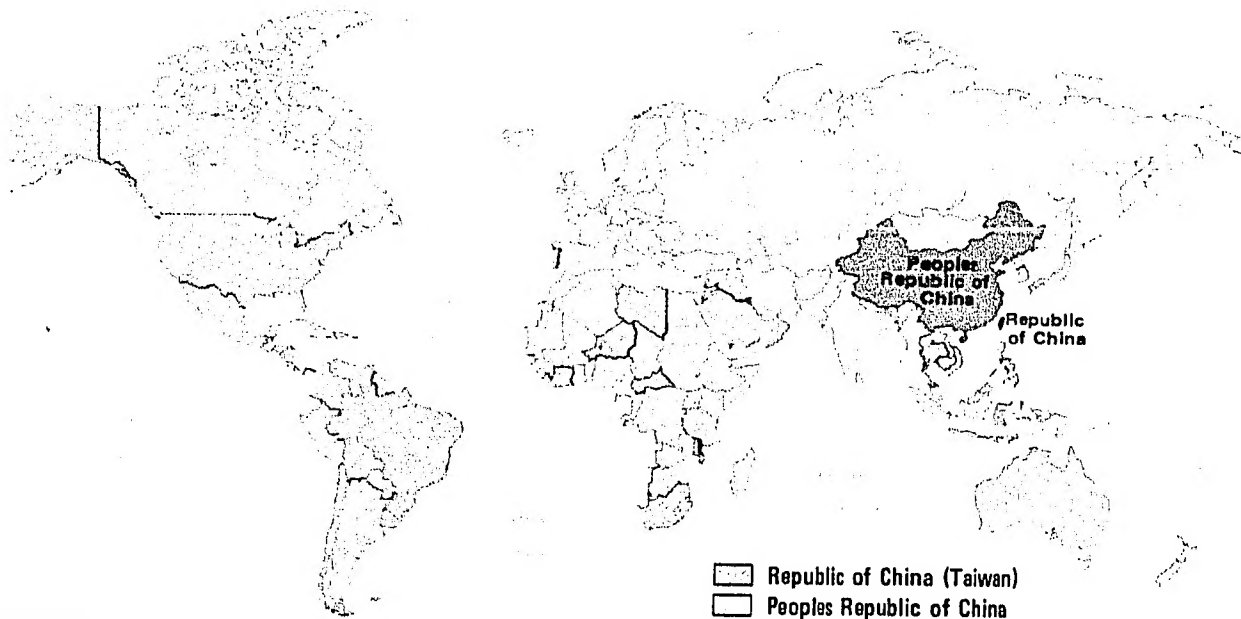
The US Connection

Relations with the US, however, are at the heart of Taipei's concern. Premier Chiang Ching-kuo recognizes that continued close political, economic, and military ties with Washington are a major element in maintaining popular morale and continued confidence in the future of the Nationalist regime. Between the announcement in July 1971 of plans for President Nixon to visit Peking, and the arrival in May 1974 of Ambassador Unger in Taipei, the Nationalist leadership underwent a period of increasing anxiety about relations with the US. Washington's detente with Peking moved faster and was more substantial than the Nationalists expected. The recent arrival of a new US ambassador and the current ferment

on the mainland have probably reduced fears of new and precipitous moves in US policy toward Peking, but many in the Nationalist leadership and in the Taiwanese business community believe that relations with Peking occupy a more prominent place in US foreign policy than does a competing concern to preserve a special relationship with Taiwan.

Taipei's immediate reaction has been to cling to ties with Washington as tightly and as long as possible, while attempting to build up a greater measure of economic and military self-sufficiency. Preservation of the US defense commitment to Taiwan, embodied in the 1954 Mutual Security Treaty, is particularly important to the Nationalists. Concurrently, the regime, while de-emphasizing the "impossible dream" of a triumphant return to the mainland, steadfastly trumpets its refusal to talk with Peking. Premier Chiang has ruled out the notion of turning to the USSR to attain more room for political maneuver—although he does allow the use of incidents, such as occasional Soviet naval units transiting the Taiwan Strait, to twit Peking. At

Nations Having Diplomatic Relations With China



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June 28, 1974

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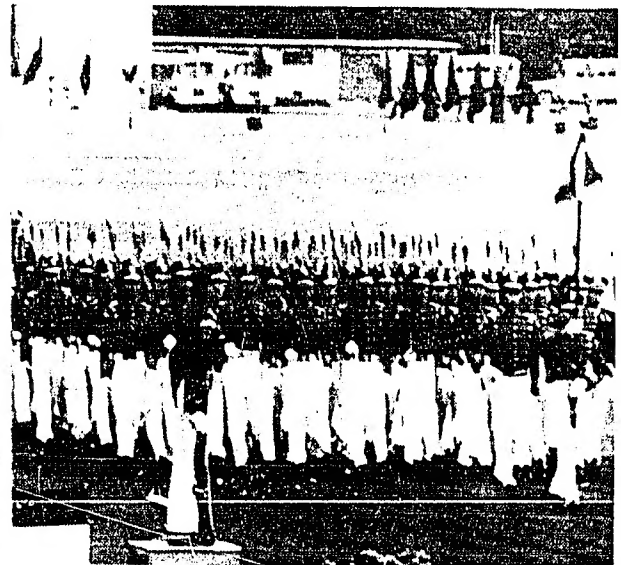
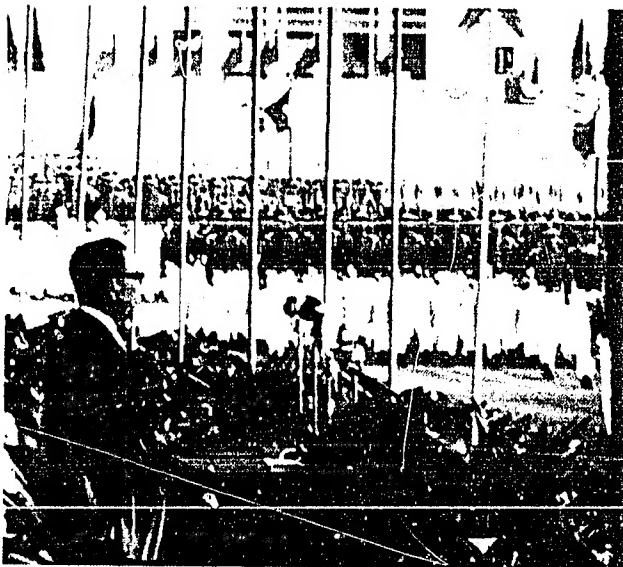
some time in the future, however, events beyond their control may force the Nationalist leaders to reconsider their absolute prohibition on talks with the mainland. Unless they feel forced to do so and they clearly have not, even when the diplomatic tide has been running strongly against them—they cannot be expected to change their mind. The Taipei government will not easily give up its claim to be the legal ruler of all China. To do so would gravely undermine the juridical basis of mainland rule and render more acute the question of Taiwanese access to real power.

The Japanese Factor

Taipei's all-out effort to maintain good relations with its major economic and political partner the US is in marked contrast to relations with its second-ranking economic associate, Japan. Tokyo's switch of diplomatic recognition from Taipei to Peking in September 1972 was a severe psychological blow to the Nationalists. Economic imperatives, however, forced Taipei to maintain close business ties. Unofficial channels of political communication were arranged and, after a short period of uncertainty, economic ties regained a high level. Nevertheless, a degree of

emotionalism has recently appeared in Taipei's handling of its relations with Japan that is absent, or at least suppressed, in its policy deliberations concerning the US. In part, this may be due to the supreme importance of maintaining special ties with Washington. Moreover, Chiang Ching-kuo's handling of the political confrontation with Japan over the issue of civil airline arrangements with Tokyo suggests that he miscalculated the relative power of political factions in Japan's ruling Liberal Democratic Party. Chiang's reaction to the conclusion of the Sino-Japanese air agreement in April 1974 was to terminate services by China airlines and Japan airlines to Taiwan and to close the island's airspace to all Japanese aircraft rather than accept Tokyo's conditions for continued civil air service. The Premier probably had little choice in making this move—he had publicly threatened to do just this in an attempt to build opposition to the proposed agreement in Tokyo. Nevertheless, Chiang was careful to keep Taiwan's economic relations with Japan separate from the civil air issue and probably hopes to resume air service after enough time has passed to save face.

The Premier's handling of the civil air issue is atypical of his efforts to adopt a more flexible



Premier Ching-kuo reviewing honor guard

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foreign policy. Taipei warned Manila that recognition of China would damage the entire spectrum of Filipino relations with Taipei, but nevertheless is formulating plans to maintain economic, civilian, and cultural ties with the Philippines even if Manila does not heed the warning. The same policy is being applied to Malaysia.

The Honeymoon Ends

After nearly two years as de facto head of the Nationalist regime, Chiang Ching-kuo's political honeymoon may be ending. His handling of the Japanese civil air issue and his tight money policy have led to the first real, if muted, criticism of his government. So far, the Premier has earned support from foes in the Nationalist old guard, as well as from his long-time supporters and the population at large, for his successful economic policies and his handling of relations with Taiwan's one indispensable friend—the US. As Washington proceeds with further normaliza-

tion of relations with Peking, and as economic problems, such as inflation and world oil prices, buffet Taipei, Chiang Ching-Kuo will face harder problems than ever before. Missteps in dealing with these problems could shake public confidence in his leadership.

His regime is not in any immediate danger. Moreover, the Premier benefits from a widespread popular belief that there is no one capable of taking his place and from the fatalistic feeling that tiny Taiwan is merely a pawn in the game of international politics. The island will probably face a succession crisis when Chiang Ching-kuo dies. There is no successor in sight, nor is the Premier grooming one. Chiang will probably be succeeded by a collective leadership, which will have to deal with the enduring problem of maintaining an independent Taiwan in a still less friendly international environment.

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